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SUBJECT: AIRBUS -- FORGING A CORPORATION FROM A CONSORTIUM

This is the first of two cables on Airbus and U.S. interests. It was drafted by APP Toulouse with support from Paris and represents the Consul's farewell report at the conclusion of a three year assignment. A subsequent message will focus on export controls.

¶1. (SBU) SUMMARY: Airbus, a division of the European Aeronautic Defense and Space Company (EADS), continues to face growing pains as it evolves from a business cobbled together from national champion aviation companies in France, Germany, Spain, and the UK into a fully integrated multinational. Seven years after this merger, remnants of the original fractured organization and its accompanying corporate culture still hamper efficient operation. To address organizational weaknesses revealed by the ambitious A380 program and significant financial difficulties, the company's management has launched a reform program that should place Airbus on the long and bumpy road to becoming a true multinational corporation as long as national governments stay on the sidelines. END SUMMARY.

AIRBUS: AN INTEGRATED EUROPEAN COMPANY?

¶2. (U) Announced in 1967 by the French, German, and British governments as a consortium of national aerospace companies, Airbus was designed to strengthen European cooperation and challenge U.S. aviation dominance. In an effort to streamline decisionmaking, the Airbus consortium reorganized itself into a single integrated company in 2001. Incorporated under French law, the four national entities -- France, Germany, Spain and the UK -- transferred their assets to, and became shareholders of Airbus while retaining separate legal structures. Headquartered in Toulouse, France, manufacturing, production and sub-assembly of parts for Airbus aircraft are distributed around 16 sites in Europe, with final assembly in Toulouse and Hamburg.

¶3. (SBU) A single, publicly-traded European corporation for over seven years, national interests remain apparent at Airbus and its parent company, the European Aeronautic Defense and Space Company (EADS). (The latter was formed in July 2000 by a merger of DaimlerChrysler Aerospace of Germany, Arospatiale-Matra of France, and Construcciones Aeronuticas SA (CASA) of Spain.) Governments have helped finance the development of Airbus aircraft through low interest loans repayable once a plane achieves profitability (i.e. launch aid). To defend their national concerns, France and Germany insisted on a complicated, nationality-based management structure in which EADS had French and German co-Chief Executive Officers, with Airbus oversight accorded to the CEO whose nationality differed to that of the Airbus President. The 2007 end to this system required the involvement of the German Chancellor and French President. Under this new cross-reporting agreement, EADS is headed by Louis Gallois, a widely-respected and well-connected French industrial manager, to whom Airbus German President -- and former EADS co-CEO

-- Tom Enders reports.

A380 -- THE TEST CASE

¶4. (SBU) Airbus' A380 program -- the first aircraft fully developed since the merger -- was expected to prove European transnationalism at its best. At the plane's unveiling ceremony in 2005, the British, French, German, and Spanish heads of state all highlighted it as a triumph of the European "dream." In reality, the A380 demonstrated Airbus' overall lack of unity and the weakness of the management structure. As short-lived Airbus CEO Christian Streiff said after a 2006 review, "Airbus is not yet an integrated company. Airbus doesn't yet have a simple and clear organization. There are shadow hierarchies -- leftovers from the never-finished integration."

¶5. (SBU) Although it claims to be multinational, national rivalries persist at every level of Airbus. When the long-time German Chief Operating Officer (COO), Gustav Humbert, succeeded Frenchman Noel Forgeard as Airbus President in 2005, employees joined the French public in expressing concern that France would be slighted in Airbus decision-making. Airbus employees also have told Consul that some claim the highest ranking American employee, COO Customers John Leahy, is a spy. Therefore, even though he is highly respected, no one could imagine him as the company's President. By the same token, most cannot imagine a scenario in which a British or Spanish citizen -- both integral parts of Airbus -- would become the President.

¶6. (SBU) Many experts believe the confused management reporting and strongly nationalistic culture contributed to the significant delays in the A380 program. The refusal of French and German engineers to use the same software in developing the A380 -- and the failure of Airbus senior management to compel them to do so -- clearly

illustrates Airbus' challenges. Due to this lack of technological communication, a five centimeter shortfall in 530 kilometers of wiring became apparent on the final assembly line. The inability to connect cabling between A380 sections led to a two-year delay in the program and the need to send 1300 German mechanics to Toulouse -- local French workers could not undertake the job since Germany is responsible for this part of the plane -- to painstakingly re-wire every aircraft at the final assembly line.

REFORM TAKES FLIGHT

¶7. (SBU) In total, Airbus' difficulties in the industrialization of the A380 will cost EADS around USD 6.6 billion. At the same time, Airbus is grappling with its first military program, the A400M, and embarking on its A350 program. The market for the latter represents the industry's future with Boeing having sold over 900 of the 787 and Airbus sales of the competing A350 at over 300. Late to the market after several unsuccessful, cheaper versions, the A350 program will require an investment of approximately 12 billion euros. Furthermore, the falling dollar has led to record losses given Airbus sells in dollars but has significant Euro-dominated costs. In 2007, the company recorded an operating loss of 881 million Euros (i.e. approximately 1.35 billion USD), up from 572 million Euros (i.e. 879 million USD) in 2006.

¶8. (SBU) In an attempt to cope with this financial situation and address its structural weaknesses, Airbus embarked in 2006 on a reform program entitled Power8. Intended to be more internally focused than previous projects, which primarily sought to pressure suppliers to lower prices, Power8 aims to significantly restructure the company. An eight point project, it seeks to radically cut Airbus' internal and external costs through a hiring freeze and renegotiating procurement contracts, speed up development by bringing suppliers into the process earlier, and streamline the production process through a rationalization of manufacturing sites.

¶9. (SBU) Viewed by suppliers, Power8 does not depart significantly from previous programs, such as Route 06, even though Airbus' current COO argues that two-thirds of savings have come from

internal changes. Under the guise of Power8, Airbus procurement is pressing for development cost sharing (i.e. suppliers' seconding engineers for product definition and defraying charges for product testing and certification), along with the usual significant price reductions. Given current exchange rates and the strength of the U.S. aviation industry, Power8's increased emphasis on a global supply chain should be a golden opportunity for U.S. suppliers. In reality, numerous U.S. executives have told Consul that they must seriously evaluate each work package's business case and sometimes choose to not bid due to stringent profitability conditions imposed by their own boards and stockholders. Although this situation is bleaker for French companies given that Airbus requires bids in dollars, U.S. business contacts have complained that their competitors can accept less favorable conditions, because the French government will subsidize them if losses become too great.

¶10. (SBU) For Power8's desired risk sharing to succeed, Airbus must overcome an insular, balkanized corporate culture found at all levels. Its goal to integrate large, often American, suppliers into the early stages of product development will fail if Airbus engineers refuse to truly cooperate due to fears of losing control of the process, according to industry sources. U.S. suppliers often complain that Airbus' working level -- both arrogant and afraid of downsizing -- keeps tight control of information, imposes changes, and rejects input. Recognizing this situation, the company's management recently emphasized at a large suppliers' conference that any supplier with a previously-rejected, cost-reducing proposal should re-submit it. A high-level supplier summarized its role in Airbus' reform as "We are the change agent," meaning Airbus management is relying on outside partners to stimulate new operating practices since it is unable to force change from above.

¶11. (SBU) The plan to manage costs by awarding larger work packages to fewer suppliers -- the upcoming A350 will have around 70 aircraft systems contracts as compared to approximately 160 for the A380 -- also will stumble if Airbus succumbs to significant political pressure to continue to buy directly from local small and medium-sized enterprises. Airbus executives have told Consul that the company has devoted significant resources to explaining its new procurement concept (i.e. reduce the overall number of Tier 1 suppliers from more than 3000 to less than 500 with the expectation that the latter will employ the former as Tier 2 suppliers) to the relevant French authorities, including government agencies, the French aerospace industry association, and Chambers of Commerce.

The company asserts that the latter accepted the need to reform even though local politicians continue their criticism.

¶12. (SBU) Even more sensitive than procurement reform is the sale of plants in France, Germany, and the UK (internally titled Zephyr). Intense political pressure, especially in France and Germany, to balance the divestitures influenced the choice of factories and time lines. A theoretically open process, Airbus ended up choosing companies from the country in which the sites are located as preferred bidders (i.e. choosing the French Latecoere for two French factories, British GKN for the one in England, and German OHB/MT Aerospace for three in Germany). Off-the-record, suppliers and Airbus contacts have stated their expectation that the reconstituted businesses will seek government funding after the sales. Airbus thus would benefit by not only removing employees from its payroll but also obtaining more state support -- though indirect -- than under the old system, which always required a careful balance of competing German and French interests. In informal conversations with executives at the French business Latecoere, they mentioned that they used their comparative appeal to French unions as a French company during negotiations. Playing off fears of American business practices, they highlighted that labor leaders would accept them more easily.

¶13. (SBU) In March, Airbus and OHB/MT Aerospace ended talks without an agreement, and EADS has announced that it will proceed by creating a holding company for the three German plants. This development may put the entire process in jeopardy if political forces interfere. Local industry sources have told Consul that the governments want Airbus to divest in France and Germany at the same

time to ensure that one country does not have more Airbus production. Airbus currently is denying this scenario, and Latecoere's integration of Airbus personnel appears on track. Nonetheless, French unions have once again called for strikes in response to the perceived preferential situation in Germany.

THE FUTURE OF REFORM

¶14. (SBU) Any revival of national tensions could create larger problems for Airbus, which is still struggling with the modernization of its peculiar governance structure. The Franco-German shareholders' pact, which officially delineates government influence over EADS, remains complicated. The agreement has created an imbroglio between political interests and market participants that has proved difficult to unravel, vesting representation of national interests in private shareholders (the French firm Lagardere and German Daimler-Benz), both of which are in the process of exiting the business. The Financial Times reported in March that France and Germany were near agreement on a proposal to give each country a "golden share" with veto power over sales to new shareholders of more than 15 percent of the company's stock. The EU Commission opposes this scheme, but France and Germany may argue that aeronautics is a "strategic" industry or could ask shareholders to adopt a poison-pill defense that has been used successfully by other Netherlands-registered companies.

¶15. (SBU) For its part, Airbus appears to realize that government involvement can be detrimental to the company. Although it sought and received launch aid commitments for the A350 from the governments of France, Germany, Spain, and the UK, it has not yet drawn this money. According to high-level sources in government affairs at Airbus, it still may employ this financing depending upon the outcome of the WTO case filed by the U.S. and internal reform. If the company can succeed in reducing costs, use of government assistance to develop the A350 appears less likely. Interestingly, during discussions of Airbus' financial difficulties, neither industry leaders nor the media currently mentioned launch aid as a response.

¶16. (SBU) Instead, in light of the continuing weakening of the dollar, Airbus has begun "Power8 plus," with a strong emphasis on low cost country/dollar sourcing. With Airbus currently claiming it spends 46 percent of its procurement budget for "flying parts" in the U.S., it especially is pushing suppliers in this direction. Airbus primarily will focus efforts on decreasing significantly the percentage of its employees based in Europe. According to the company's current COO, Airbus aims to reduce in the next ten years its European workforce from 97 percent of total employees to between 70 and 80 percent. Plans to open final assembly lines -- the company's strongest symbol -- in China and Alabama will assist this goal. So far, Airbus has mastered the communication related to this controversial move, suffering little political or union backlash. However, if the French begin sensing a loss of Airbus jobs and equilibrium with the Germans, this calm could quickly end.

¶17. (SBU) COMMENT: Airbus' recent reform program shows that its upper management recognizes the necessity of becoming a more integrated, global company in order to succeed, especially in light of the falling dollar and efforts to forego launch aid. However, such a transformation will not occur quickly or smoothly because of the rival vision of relevant governments and parts of Airbus itself. They still view the corporation as a collection of national champion companies, which primarily exist to advance national pride and create well-paid employment. As long as aircraft sales continue at their current extraordinary rate, allowing globalization to occur without threatening European jobs, Airbus should manage to slowly implement its vision. Any number of factors -- a further depreciation of the dollar, significant tariffs on planes due to a negative WTO outcome, the rise of an aircraft manufacturer in China or Russia, a French government decision to use Airbus as a last stand against globalization -- could upset this precarious balance.

Stapleton